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AIG to return $138 million of state's pension funds

The state-run fund lost about 12 percent of its value — over $1 billion — since the start of the year.

BY STEVE PEOPLES and KATHERINE GREGG
JOURNAL STATE HOUSE BUREAU

PROVIDENCE — Rhode Island leaders averted a financial disaster yesterday after the troubled insurance giant American International Group agreed to return $138 million that had been locked in AIG investment accounts.

"We successfully worked all day and yesterday to get this money released," the governor's budget officer, Rosemary Booth Gallogly, said yesterday, a day dominated by news of the federal government's 80-percent takeover of the international insurance powerhouse.

But even as one calamity was avoided, state leaders acknowledged that the continued struggles of Wall Street titans has had a profound effect on the state's retirement portfolio for 45,000 current and former state workers and teachers.

The state-run pension fund lost $1 billion — 12 percent of its value — since the beginning of the year. More than 60 percent of the fund is invested in publicly traded companies.

The failures of high-profile institutions such as AIG, Lehman Brothers, Merrill Lynch and Bear Stearns were directly responsible for losses totaling $81 million since January, according to information released yesterday by General Treasurer Frank T. Caprio.

"We as a state and we as a pension fund go forward both with the good and the bad that may result in being a long-term investor," Caprio said, noting that it's not uncommon for the fund to gain or lose $80 million in a single day. "We're not selling because of any panic in the market. Quite the converse, we're looking to add to positions when we think opportunities exist."

Rhode Island's pension problems are not unique, according to Ryan Francis, spokesman for Washington D.C.-based National Conference on Public Employee Retirement Systems.

He noted that national markets over the last year have fallen 19 percent, compared with Rhode Island's pension fund loss of 12 percent — from $8.4 billion at the beginning of the year to $7.38 billion on Monday.

"Twelve percent, is that excessive compared to the markets? I really don't think so," Francis said. "When you talk about billions of dollars, it certainly can seem disconcerting, but the market does what it does and there are peaks and valleys. Right now we're going through a troubled period and that will likely turn around."

In neighboring Connecticut, state treasurer Denise Nappier acknowledged this week that her state's fund lost 1.3 percent, or $324 million, on Monday alone.

"As long-term investors with a well-diversified portfolio, we are positioned to weather this latest turbulence," she said. But, "what we are facing are serious concerns about systemic risk — these financial institutions are counterparties to a web of financial transactions that affect every aspect of the capital markets."

Rhode Island's two largest cities — which manage pension funds independent of the state's retirement system — didn't escape the fallout.

Through the end of August, Providence finance director Bruce Miller said, the value of the city's pension portfolio this year has dropped 7.9 percent, or $27.3 million.

Warwick's pension fund has also dropped in recent months, although the specific numbers weren't available yesterday.

Pension fund adviser Anthony J. Tranghese said, "Certainly the pension plans are exposed to the broader market and as such have suffered due to that exposure." But, he said, "we do ultimately view the pension plans with a long-term lens and as such, expect a bounce-back at some point."

Several days of negative financial news prompted state House Finance Committee Chairman Steven M. Costantino to push for legislative oversight yesterday.

In a letter to Caprio, Costantino formally requested "a detailed accounting of all investments, guaranteed investment contracts or other instruments though which state assets are held or insured." The Democratic lawmaker wants the information before the end of the month, noting that Wall Street's troubles "raise important questions concerning the potential risk to state assets."

The state does not invest directly in the troubled companies such as Lehman Brothers or Bear Stearns, but does invest 20 percent of its pension fund in the S&P 500, which includes such financial institutions. Investment decisions are made by the State Investment Commission, which is chaired by Caprio.

The commission recently hired new consultants, who plan to conduct an "asset allocation study" in the next three to six months, according to the general treasurer's chief of staff Mark Dingley. That study may result in a recommendation to change the state's investment strategy, but there are no current plans to do so.

But there are tens of millions of dollars of Rhode Island's money at risk aside from the pension fund.

State officials worked yesterday to ensure it would not lose at least $138 million tied up in "guaranteed investment contracts" with AIG.

In this case, AIG acts as an interest-paying savings account for state agencies — including the Department of Transportation, the Rhode Island Clean Water Finance Agency and Rhode Island Housing — that receive bond revenue to pay for large capital projects.

State officials feared earlier in the week that the money could be lost, or at least tied up in legal proceedings. But after repeated discussions over a two-day period, the state received written notice yesterday from AIG that the funds would be wired back in the next five to eight days, according to Gallogly.

Caprio said state leaders would probably decide today where to invest the money.

Municipalities may face similar decisions. Providence, for example, has $900,000 in one AIG account, according to finance director Miller. AIG's 5.3-percent interest rate helped finance the borrowing costs associated with school projects, he said, adding that he doubts the city could find another place to park the money with a comparable rate.

Meanwhile, there is no immediate danger for state employees and teachers whose retirements are drawn from the pension fund, a combination of both employee and taxpayer contributions. Most retired state workers and teachers will receive guaranteed pension payments for life, regardless of the stock market's performance.

But taxpayers may be on the hook should the fund fail to rebound.

Any shortfall would be made up by the "employer," which in this case is the state. Already, Caprio notes, taxpayers contribute half a billion dollars each year to the fund.

That contribution is determined by a "smoothing" process that looks at the fund's performance over a five-year period. The system is designed to guard against major dips and spikes over a single year.

Gallogly said that history suggests the fund will rebound and taxpayer contributions won't jump too high. But, she noted, if Wall Street's recent performance "is a new trend, then that's a different story."